DIFFICULT TIMES FOR PATENT LICENSING FOR HIGH TECHNOLOGY COMPANIES

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Despite the fact that worldwide patent royalties have increased from annual rates of about $1 billion in the early 1980's to a current level of more than over $100 billion[1], today's patent licensing environment is extremely challenging for business of all types. The proliferation of issued patents in recent years means that there are literally "thousands" of patents that may read on common electronic devices. Large technology companies have contributed greatly to the increase in issued patents. More than a decade ago, Microsoft had a few patents; today it has in excess of 5,000 U.S. patents[2]. In Korea, Samsung now has over 18,000 U.S. patents[3]. At the same time, patent licensing revenues have increased more than ten fold. U.S. patent litigation has increased each year over the past decade. As more money has been allocated to patents and other intellectual property assets, companies have become more sophisticated. Companies now demand that they pay royalties for only "good" patents that would withstand litigation and not pay for a portfolio of "junk" patents. Companies also use extremely advanced and complex prosecution and litigation strategies in an attempt to extract licensing revenues from their patents. As companies evolved, the U.S. government and judiciary became increasingly involved. Recently, the U.S. Supreme Court indicated that there are no automatic injunctions in patent cases. Such cases would require application of a four-factor test to determine if an injunction would be suitable. The "good old days" are gone when companies paid "big bucks" for a large portfolio of questionable patents owned by some

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[1] The Economist, 22 August 1992, 56; Fred Warshofsky, The Patent Wars: The Battle to Own the World's Technology (New York: Wiley, 1994), 30, Kevin G. Rivette and David Kline, Rembrandts in the Attic (Harvard Business School Press, Boston, Massachusetts), 6.

[2] U.S. Patent Database as of August 9, 2006. In addition to the over 5,000 currently own patents, Microsoft also has over 13,000 applications pending. See *Innovation and its Enemies*, THE ECONOMIST, January 12, 2006.

[3] U.S. Patent Database as of August 9, 2006

of the world's largest companies. This paper focuses on the changing landscape of the licensing environment and ways to continue to extract value from patents.

History

Before 1982, enforcement of patents in the consumer electronics field was difficult in the U.S. There was little incentive to extract revenues from intellectual property created by research and development efforts. The focus of most companies was to manufacture products and generate revenues from the sale of actual products. Most licensing negotiations, if any, were friendly, which ultimately lead to the licensing of the "integrated circuit" from Fairchild Semiconductor or Texas Instruments Incorporated. A major change occurred in the United States, however, with the advent of tough competition in electronics coming from Asia.

In particular, Japanese companies began to dominate consumer electronics from television sets to computers, and audio equipment. To help strengthen the U.S. Court system under the administration of President Ronald Reagan, the Court of Appeals for the Federal Circuit[4], commonly called the CAFC, was created. As the Federal Appeal Court with nationwide jurisdiction, the CAFC is specialized in a variety of areas, including patent disputes.[5] Better enforcement of patents then became possible.

In the electronics field, Texas Instruments was one of the first U.S. companies to effectively use the patent system to extract fair value for its patents. As background, Texas Instruments ("TI") was one of the first licensees of the transistor devices from American Telephone and Telegraph, commonly called AT&T. Jack Kilby of TI was also credited with inventing the integrated circuit, which issued as U.S. Patent No. 3,138,742[6]

[4] See, http://www.fedcir.gov, "The United States Court of Appeals for the Federal Circuit was established under Article III of the Constitution on October 1, 1982. The court was formed by the merger of the United States Court of Customs and Patent Appeals and the appellate division of the United States Court of Claims." Last accessed on August 9, 2006.
[5] *id*.
[6] J.S. Kilby, Miniaturized Electronic Circuits, U.S. Patent 3,138,743

(along with Robert Noyce[7] of Fairchild Semiconductor). For years, TI was one of the largest semiconductor companies in the world and manufactured a product called the dynamic random access memory device or "DRAM." In the mid-1980's, competition for the manufacture of DRAMs was fierce. Most of the competition was based mainly in Asia. To extract revenues from TI's competitors, TI decided to sue first and talk later, which resulted in filing patent law suits against the Japanese DRAM makers and Samsung. TI demanded royalty rates of about 10%, which was much higher than any others in the semiconductor industry. TI achieved success - In 1992, for example, TI's revenues from royalties exceeded operating profits.

After TI's success, many other companies began licensing patents in the electronics field. IBM reported over $1 billion[8] per year in royalty income from technology assets, including patents. Licensing also occurred in the computer networking field, hard disk drive field, and computer software field. In response to royalty demands from U.S. companies, foreign companies have been increased their efforts in securing patents[9]. In 2005, six out of ten top patent recipients were foreign companies. In addition to obtaining patents, Japanese, Canadian, European, and Korean companies also began licensing programs. Emerging economies such as China and India have become a major source of royalties in the U.S[10]. Many U.S.-based companies even transformed from product-based companies to pure patent licensing companies. These companies include Rambus Inc., Qualcomm, Acacia Research Corporation, and others. Depending upon the type of patent holder, terms such as "Patent Troll"[11] and "Pirate(s)" have emerged to describe some of these companies and others like them.

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[7] Robert N. Noyce, Semiconductor Device-and Lead Structure, U.S. Patent 2,981,877

[8] In 2001, IBM made $1.7 billion from its patent portfolio. See *More Rembrandts in the attic*, THE ECONOMIST, January 17, 2002

[9] In 2005, IBM was the top leader, receiving 2,941 patents, followed by Canon, Hewlett-Packard, Matsushita, Samsung, Micron Technology, Intel, Hitachi, Toshiba, and Fujitsu. See *Innovation and its Enemies*, THE ECONOMIST, January 12, 2006.

[10] In 1996, China paid less $200 million for U.S. royalties. In 2003, China paid over $800 million for U.S. royalties. See *Thinking for themselves*, THE ECONOMIST, October 20, 2005.

[11] "[Patent trolls] are smaller firms that invest in buying patents with the sole purpose of seeking out and suing infringers. They use the threat of injunctions to force firms that have breached their patents, wittingly or unwittingly, to pay big sums to keep their businesses going." *See* THE ECONOMIST, Mar 30th 2006. However, "patent trolls" are not always limited to small firms.

The licensing companies received huge patent awards. For example, the first three months of 2005 saw a "boom" of large patent awards (examples which are listed below):

- RIM and NTP – RIM's verdict of $450,000,000
- Infineon and Rambus - Infineon pays up to $147,000,000
- Medtronic and Karlin Technology Inc. - $1,350,000,000
- HP and EMC - HP pays $325,000,000

As noted above, patent damages reached over one billion dollars for Karlin Technologies Inc. which is owned by Dr. Gary K. Michelson, M.D. Things could not get any better for the patent licensing field. Most recently, damage awards have been reduced. In the sole month of July 2006, patent awards were reduced dramatically, which may possibly indicate a shift or be only a temporary glitch in the trend of increasing damage awards.

- Freedom Wireless v. Boston Communications Group-$55 Million Final Settlement (July 2006)-reduced from Jury Verdict of $128 Million

- Rambus v. Hynix (July 2006)-Judge reduces $307 Million award by $174 Million

- Trit Tek Research v. Alliance (July 2006)-Settlement reduce to $3 Million from $172 Million

These reduced awards suggest that any weakness in a patent case can yield lower damages. The lower damages lead to a more difficult licensing environment for patent holders. Today's licensing environment, which is more critical to any weaknesses in the patent, requires a sound licensing program, including strong patents, effective licensing tactics, and reasonable expectations.

Licensing Programs

Many owners of patents have targeted patent licensing programs beginning with Asia-based companies. The Asia-based companies generally reside in Korea, Japan, Taiwan, and China. Typical U.S.-based licensing programs often pick Japanese companies as licensing targets first; Korean companies often follow the Japanese; and Taiwan and China are the last in Asia. U.S. companies then attack other U.S. companies. Many U.S.-based companies do not understand Asia. Because many U.S.-based companies do not understand Asia, licensing efforts against Asia-based companies often end in frustration and even litigation. Richard L. Donaldson, who pioneered the licensing program at TI, explained the difficulties of licensing in Asia based upon the following factors.

Asia Pacific Factors[12]

Effectiveness of enforcement has been directly related to the level of economic development of a country. Countries have gone through four distinct phases regarding intellectual property enforcement. These phases include:

"1. Ignore. This is the survival instinct. The end (a successful business) justifies the means (infringing intellectual property). This attitude is often found in newly-developed countries."

"2. Police Pirating. Developing countries are often forced by international pressure to enact laws protecting owners of intellectual property from piracy. This generally occurs with respect to copyright and trademark protection. Infringement is easy to detect and is easily understood to be theft. Criminal sanctions are typically enforced. It is much more difficult to enforce anti-piracy laws against patent infringement unless it is a clear copy, and even then the remedy does not include adequate damage compensation."

[12] Richard L. Donaldson, International Patent Strategy-Considerations for Licensing IP In Asia, USC Law School 2004 Intellectual Property Institute, (May 25, 2004)

"3. Enact IP Laws. The next level of intellectual property protection is enactment of comprehensive IP laws. This too is generally in response to pressure from the international community. The country wants to be able to participate in international trade without economic sanctions, and thus complies with the requirement to enact laws protecting intellectual property. Obtaining effective enforcement, however, is usually quite difficult."

"4. Understand IP Protection is in self-interest. Countries in this category recognize that a strong IP environment fosters economic growth. IP laws are enforced uniformly without bias, and damages for infringement are adequate to compensate the patent owner."

According to Mr. Donaldson, "trying to enforce IP in any country that is not at level four will most likely be unsatisfactory to the patent owner trying to obtain significant royalty or damages…thus, the only viable option to a patent owner, if he wants to secure significant economic damages, is litigation in a country such as the United States, or Europe, and leverage the threat of an injunction against export to such countries as a means of getting significant royalties."

Many U.S.-based companies have taken TI's approach to licensing patents to Asia-based companies. That is, there is an initial assertion of a set of "Proud Patents" - up to about fifty or so against an Asia-based company. After that, meetings take place to discuss the technical merits of the patents against the allegedly infringing products of the Asia-based company. Often times, these meetings are fairly lively and lead to raised voices, increased tempers, and frustration for each of the parties. A certain amount acrimony is required, however, since defending against patents must be done aggressively and with complete commitment. In our experience, we learned that it is often easier to defend against a patent by asserting multiple theories of invalidity and non-infringement. A summary of tips for a good defense and offense is provided below.

1. **Strategic use of legal theories**: Many patents could be challenged using multiple non-infringement and invalidity positions. Depending upon the course of negotiations, a defendant of a patent during licensing negotiations should strategically use one or more or all of the positions in a time-based manner. That is, the defendant must try to achieve the goal of having the strongest position during the last and final meeting, which would end all technical discussions, unless the patent has been completely defeated before then. The selection of legal positions must be carefully used to achieve this goal: although defending against patents aggressively is a good tactic, a good offense is often the best defense.

2. **Use the best technical talent**: In most if not all companies, the best technical talent is used to develop real products. The technical talent is often not used for defending against patents or developing offensive patent positions against potential infringers. It is, however, critical to use the best and most experienced engineers for the particular technology area of the patent, whether for offensive or defensive purposes. The experienced engineer would have the best insight of any prior art, enablement attacks to the patent, and possible ways to design around the patent, if the patent is being infringed. For offensive purposes, the experienced engineer would know the types of products that may infringe and also understand the latest and greatest technology, which may be covered by the patent. Anything short of the best technical talent will not yield the best results.

3. **Hire the best lawyers**: Similar to the best technical talent, experienced licensing lawyers must be used to defend against or assert patents. The lawyer must have good technical knowledge, solid legal skills, and an ability to argue in a hostile face- to-face environment. The lawyer along with any technical support must be able to convince the other side that the patent being asserted has no value or convince the other side that it should take a license to the patent.

4. **Attitude and behavior**: Defending against or asserting a patent requires confidence and sometimes even aggressive tactics. The patent holder will often use

aggressive arguments and tactics in asserting its patents. To effectively rebut the arguments, defending against the patent also requires at least the same level or preferably a higher level of aggressiveness. The defendant must demonstrate that the patent has problems and that the patent holder will not succeed during the course of litigation. The patent holder must show confidence that it will win through the course of litigation.

5. **Schedule with deadlines**: Patents often become weaker during licensing negotiations, unless the patent has been upheld in litigation. The patent holder will attempt to set schedules and milestones for the licensing meetings and negotiations. The patent holder often attempts to force the defendant to take a license before any problems are found in the patent. To defend against these schedules and milestones, it is important to make sure that the defendant of the patent meet with the patent holder only if the defendant is ready to meet. The defendant should make sure to fully understand the patent, its merits, and weaknesses before meeting with the patent holder. On the offensive side, timing and scheduling of meetings, including technical and legal must be adhered to strictly. As noted above, the defendant may try to "delay" the meeting. The patent holder should strive to meet scheduling deadlines and milestones to show that the patent holder is serious about securing a license and will, if needed, resort to litigation using the court system.

6. **Understand the opponent**: Like any adverse process, it is important to fully understand the "enemy," whether the setting is an offensive or defensive meeting. That is, the defending company should understand the patent holder's track record, litigation strategies, and other licensing negotiations. From the offensive side, the patent holder should understand if the defending company has any counter claims, including litigation tactics, negotiation strategies, and other tactics. Many times, defending companies may use a "straw person" to negotiate on behalf of the company. The straw person has no authority and often changes from meeting to meeting. Understanding the patent holder or defending company also often means a full understanding and appreciation of corporate culture and local and business practices.

7. **Presentation materials - practice, and more practice**: Having professional looking presentation materials and a well-rehearsed presentation is critical. As emphasized above, the defendant must convince the patent holder that its patent lacks merit and is unworthy of licensing. To do this, the defendant must practice, practice, and practice even more. On the offensive side, the patent holder must convince the defending company to take a license. The patent holder should have professional looking reverse engineering materials, claim charts, and a well-rehearsed presentation. We cannot stress enough the importance of having practice sessions before the face-to-face meeting. Practice makes perfect!

8. **Be persistent and patient**: Patent licensing requires a high level of patience and persistence. Each side desires to convince the other side that its patents are worthless or worthy of licensing. Many times licensing discussions can last for at least one year and longer. On the offense side, the patent holder would like to meet each month but no longer than a six-month time interval should lapse between two meetings. On the defensive side, delaying meetings is a good strategy in weakening the patent holder's position, unless the patent holder has an opportunity to strengthen the patent through litigation.

9. **And always show respect!**

The points addressed above provide general guidelines for patent licensing negotiations. Depending upon the nature of the negotiations and parties, there can be variations, alternatives, and modifications. Each patent licensing matter should be carefully evaluated and licensing strategies should be formed on a case-by-case basis. No two licensing negotiations are exactly alike.

More Changes

The patent system continues to evolve. On May 15, 2006, the U.S. Supreme Court issued a unanimous decision in favor of eBay in *eBay, Inc. vs. MercExchange, L.L.C.*, reversing the Court of Appeals for the Federal Circuit (CAFC) and remanding the case for further determinations by the trial court. MercExchange had sued eBay and Half.com for patent

infringement in U.S. District Court in the Eastern District of Virginia. While a jury found infringement, the District Court denied MercExchange's motion for a permanent injunction. The CAFC reversed, however, applying its "general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances." In its ruling, the Supreme Court rejected the CAFC "general rule" test and held that the traditional four factors that apply to all injunctions also apply to patents: The plaintiff has to demonstrate (1) that it has suffered irreparable injury; (2) that remedies available at law (money damages) are inadequate to compensate for that injury; (3) that considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction. Based on the decision of the eBay case, patent licensing companies may have more difficulty in obtaining an injunction against a defendant in a patent suit.

Other possible changes in U.S. law could dramatically effect patent licensing programs in the U.S. These changes include, among others, continuation practice, which has been popular with many licensing companies to secure important areas of technology. The new law generally proposes a single continuation application, which is a departure from the almost unlimited number of continuation applications. There are also new laws being proposed in Congress under H.R. 5096[13]. All of these changes should be considered in effectively preparing a patent licensing strategy in today's environment and patent holders are well-advised to monitor developments in this rapidly-changing area of law.

Conclusion

The patent licensing world is become more sophisticated today. Large damage awards are still possible but would require good patents and strategies. There is now simply too much at stake to not take patent rights seriously.

[13] H.R. 5096 (the "PDQ Act") was introduced in the House of Representatives on April 5, 2006 by Representatives Berman and Boucher. An earlier bill, H.R. 2795, remains pending and under consideration in modified form (called the "Coalition Draft").

About the Author:

Richard T. Ogawa has more than twenty years of experience in the electronics industry and is a patent attorney and partner at Townsend and Townsend and Crew, LLP ("Townsend"), which is Silicon Valley's most prestigious intellectual property law firm. He specializes in the area of electrical patent prosecution, including the preparation of patent applications and opinions in the fields of semiconductors, integrated circuits, optical networking, Internet, networking, communication, memory disks, and other related technologies. He also provides counseling for litigation, patent, trademark, and trade secret matters for large and small companies, with an emphasis on emerging companies. Mr. Ogawa's has a great deal of experience in technology licensing, as well. Mr. Ogawa has studied patent portfolios of many large companies and has also negotiated against such companies in licensing matters. He also serves on advisory boards of Silicon Valley companies.

For many years prior to joining Townsend, Mr. Ogawa held a variety of positions in the electronics industry. Most of these positions were at NEC Electronics in the manufacture of semiconductor devices and assembly operations, including packaging and testing of integrated circuits. The positions included process engineer and various senior management positions at NEC Electronics, where he oversaw the start up of a major chip fabrication facility.

Mr. Ogawa received a B.S. in Chemical Engineering from the University of California, Davis in 1984, and he received a J.D. from McGeorge School of Law, University of the Pacific in 1991. He is a member of the California State Bar and a registered United States Patent Attorney. He is also a member of the American Intellectual Property Law Association. Mr. Ogawa also serves as a partner member for Technology Group 2800 of the United States Patent and Trademark Office.

Mr. Ogawa has made presentations in the field of intellectual property for companies and organizations, including presentations for SEMI at SEMICON West in 1996, 1998 and TAIWAN SEMICON in 1997. Mr. Ogawa taught extension courses directed to intellectual property at the University of California, Berkeley and University of Washington. The courses include "Internet Start-Ups-Legal Issues" and "Intellectual Property Development and Management for the Semiconductor Industry." He authored "Internet Start-Ups-Legal Issues," Practical advice for the Internet start-up company, California Lawyer Magazine (November 1999). Mr. Ogawa was also the opening speaker for the U.S. Patent and Trademark Office sponsored Customer Partnership Meeting (1999) at Silicon Valley. Mr. Ogawa was also an instructor for Continuing Education of the Bar, California, an instructor for Practicing Law Institute, and serves as advisor for the University of Washington, School of Law and the University of Southern California.

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